THE DANA VIEWPOINT

January 8, 2008
Dow: 12,589

PUSHING ON A STRING

That would be the Fed. It looks like another cut in interest rates when the Fed meets later this month. The problem as we have stated in the past is not interest rates. Interest rates are low by all historical standards. Money is not the problem either. There is plenty of money out there. The problem is confidence. Actually a lack of confidence. Lenders are afraid to lend and borrowers are afraid to borrow. Remember interest rates in Japan in the 1990s? They were practically at zero yet the economy was stagnant because of a lack of confidence in economic growth. So how do we get that confidence back? Low interest rates will not do it. Investors need to see that the housing slump and the credit crisis have hit bottom. Investors are still waiting fearfully for the other shoe to drop – either a bank failure or a major builder going bust. We are seeing corporate America taking aggressive steps to prevent that from occurring. Financial institutions are writing off bad loans, cutting dividends and building up their cash reserves. Companies are paring back staff – the unemployment number jumped to 5% at last report. We are encountering some short-term pain, but this will result in long-term gains. Once investors feel confident that the worst is over, the economy will resume its upward trend. Will we encounter a recession before this happens? Not likely. A recession is defined as two consecutive quarters of negative growth in GDP.

Our economy is very diverse and there are some areas of growth that will pick up the slack in housing, namely pharmaceuticals, health care and defense spending, just to name a few. In addition, some American and foreign companies are still building manufacturing plants here to take advantage of our giant economy ($13 trillion). Add to this an explosion of spending for the repair of roads and bridges across the country. Also, with the increasing number of inferior and dangerous products coming out of China, we can expect consumers to turn more to American made products. Now, we don't profess to know when investors' mood will turn, but it will be soon and it will be the start of the next boom in the American economy.

What, if anything, could derail our rosy outlook? A repeal of the Bush administration's tax cuts. In fact, we could use further tax cuts to reverse the current slowing of economic growth, and we are talking about both corporate and personal income taxes. The corporate income tax rate in the US is currently 35%. That is the second highest rate in the world after Japan. The average corporate tax rate in the seventeen most developed countries in the world was 31% in 2006, down from 38% in 1994 and 57% in 1982. This number is from the OECD (Organization for Economic Cooperation and Development). Even Sweden, that bastion of

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socialistic democracy, has lowered its corporate tax rate from 61% in 1982 to a current rate of 28%. France will soon lower their rate to 25% and Ireland has the lowest rate of all OECD countries at 11%. Ireland of course has one of the fastest growing economies in the world. The biggest threat to the US economy is coming from tax competition. Kuwait is reducing their tax on foreign corporations from 55% to 15% to attract more investment. The rest of the world is beating us at our own game.

What about personal income taxes? They should also be cut again to make us more competitive with the rest of the world. Many like Russia are moving to a flat tax rate. Tax cuts benefit everyone, not just the rich. In 1990, the richest 5% of Americans earned 27% of all income but paid 44% of all taxes. Today, the richest 5% earn 36% of all income and pay 60% of all income taxes. The richest 10% of our population pay 70% of our income taxes. This data come from the IRS. If the tax cuts are allowed to expire in 2010, we will face the largest tax increase in history (nearly $1.9 trillion over seven years), raising taxes on 115 million taxpayers and returning to the tax rolls 7.8 million low- and middle-income families who now pay no federal income tax (*Wall Street Journal 1-8-08*).

In sum, cutting taxes serves as a stimulus to work, to invest, to create jobs and to save. That is the basic principle behind a capitalistic democracy. The budget deficit vs. GDP has been shrinking since the last tax cut and is now down to 1.2% of GDP vs. 4% in 1982. This in the face of the war on terror, Katrina and numerous other disasters.

As we head full steam into this election year, we will be bombarded with negative outlooks on the economy (by both parties actually), the war on terror, the oil crisis, the housing bubble and anything else politicians can think of to get themselves elected. We are an optimistic country and that "can do" spirit is what keeps us moving forward. We have overcome many obstacles in the past 230+ years and will no doubt overcome many more. Politicians like to talk about change, but it needs to be constructive change, and we should be looking at economic changes that will maintain our competitive edge in the world.

Random thought for January:

"Success is the ability to go from one failure to another with no loss of enthusiasm."

Winston Churchill

Michael L. Dana
Chairman of the Board

James W. Ivey
President

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